

# A&E CONSULTANT CONTRACT REVIEWS AND INDIRECT COST RATE AUDITS AND REVIEWS

Presented by Caltrans Audits & Investigations



# TOPICS

- FAR Compliant Indirect Cost Rate
- CPA Indirect Cost Rate Audits
- Safe Harbor Indirect Cost Rate
- LAPM Chapter 10.3 ~ A&E Consultant Audit and Review Process



# *Standards that Apply*

- 23 Code of Federal Regulation (CFR) Chapter 1 Part 172 – *Administration of Engineering and Design Related Service Contracts*
- 48 CFR, *Federal Acquisitions Regulation Systems*, Chapter 1 – *Federal Acquisition Regulation*, Part 31- *Contract Cost Principles and Procedures*
- 48 CFR – *Federal Acquisition Regulation (FAR)*
- 48 CFR Chapter 99 – *Cost Accounting Standards*, Subpart 9900
- 49 CFR, *Transportation*, Subtitle A, Office of the Secretary of Transportation, Volume 1 Part 18, *Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Government*



## *Standards that Apply*

- 49 CFR Part 18.20 – *Standards for Financial Management Systems*
- 23 U.S.C. – *Letting of Contracts*
- United States Government Accountability Office, *Generally Accepted Government Auditing Standards (GAGAS)*
- American Institute of Certified Public Accountants, *Generally Accepted Auditing Standards (GAAS or GAS)*
- Caltrans' Local Assistance Procedures Manual (LAPM).
- Project Program Supplemental Agreements
- Contract terms and conditions
- Caltrans Contract Requirements and Specifications
- Federal Highway Administration, Safe Harbor Indirect Cost Rate Test & Evaluation Project Work Plan



## *Resources Available*

- AASHTO Uniform Audit & Accounting Guide  
<http://audit.transportation.org/Documents/UAAG-3%20FINAL.pdf>
- DCAA (Defense Contract Audit Agency) Contract Audit Manual
- Internal audit and accounting staff
- Independent CPA
- FHWA Procurement, Management, and Administration of Engineering and Design Related Services - Questions and Answers -  
<http://www.fhwa.dot.gov/programadmin/172qa.cfm#q01>
- National Compensation Matrix -  
[http://audit.transportation.org/Documents/2012\\_National\\_Compensation\\_Matrix\(FINAL 5-7-12\).xls](http://audit.transportation.org/Documents/2012_National_Compensation_Matrix(FINAL%205-7-12).xls)
- National Highway Institute (NHI) Training  
<http://www.nhi.fhwa.dot.gov/default.aspx>
  - Using the AASHTO Audit Guide for the Procurement and Administration of A/E Contracts (FHWA-NHI-231028)
  - Using the AASHTO Audit Guide for the Development of A/E Consultant Indirect Cost Rates (FHWA-NHI-231029)
  - Using the AASHTO Audit Guide for the Auditing and Oversight of A/E Consultant Indirect Cost Rates (FHWA-NHI-231030)



# FAR Compliant Indirect Cost Rate



# FAR COMPLIANT ICR

## *Purpose and Objective*

Purpose: To highlight frequently identified issues encountered by A&E firms when developing an Indirect Cost Rate (ICR)

Objective: To help A&E firms be successful in developing a FAR compliant ICR



# FAR COMPLIANT ICR

## *Frequent Issues with A&E ICRs*

- Some reasons why Accounting Systems fail - properly designed system should (not limited to):
  - Segregate direct, indirect, and unallowable costs
  - ID and accumulate direct costs by contract/project/cost objective
  - Accumulate costs under GL control
  - Periodically reconcile costs charged to contracts every 30-days
  - Exclude unallowable costs to contracts

*Table 8-1, Common Unallowable Costs, p84, 2012 AASHTO Guide*





# FAR COMPLIANT ICR

## *Frequent Issues with A&E ICRs*

### *Example*

- Inadequate (project) job cost system
  - No separate G/L acct. for direct, indirect, and unallowable costs
  - No ability to identify direct costs by contract
  - Inability to identify unallowable costs that should not be charged to contracts

*Table 6-1, Labor Charging Checklist, p52, 2012 AASHTO Guide*



# FAR COMPLIANT ICR

## *Frequent Issues with A&E ICRs*

- Inadequate procedures over labor charging system. Proper procedures should include:
  - Requiring ALL employees to record ALL hours worked, paid or unpaid, even if over 8 hrs/day or 40 hrs/wk
  - Account for uncompensated OT
  - Ensure proper distribution of labor costs
  - Periodically reconcile Job Cost System to the GL, (i.e., every 30 days)



# FAR COMPLIANT ICR

## *Frequent Issues with A&E ICRs*

### *Example*

- No/Inadequate procedures over the labor charging system
  - Many salaried employees who do not receive OT pay (e.g. uncompensated OT) do not record their hours in excess of 8hrs/day or 40hrs/wk unless they work directly on a project
  - Even if OT is not paid, all time worked over 8hrs/day or 40hrs/wk (indirect & direct) must be recorded on time sheets



# FAR COMPLIANT ICR

## *Frequent Issues with A&E ICRs*

### Salary Variance Method - Standard Rate Example

					Standard				
	Direct	Indirect	Hours	Annual	Hourly	Direct	Indirect	Labor	Total
	<u>Hours</u>	<u>Hours</u>	<u>Worked</u>	<u>Salary</u>	<u>Rate</u>	<u>Labor</u>	<u>Labor</u>	<u>Variance</u>	<u>Labor</u>
<u>Employee</u>									
Smith	2,000	600	2,600	\$ 72,800	\$ 35	\$ 70,000	\$ 21,000	\$(18,200)	\$ 72,800
Ending Direct Labor:		\$ 70,000							
Ending Indirect Labor:		\$ 2,800	(\$21,000 - \$18,200)		(2,600 - 2,080 = 520 X \$35 =		\$18,200)		2,080 = Std hrs/yr

### Salary Variance Method - Effective Rate Example

					Standard	Effective				
	Direct	Indirect	Hours	Annual	Hourly	Hourly	Direct	Indirect	Total	Labor
	<u>Hours</u>	<u>Hours</u>	<u>Worked</u>	<u>Salary</u>	<u>Rate</u>	<u>Rate</u>	<u>Labor</u>	<u>Labor</u>	<u>Labor</u>	<u>Variance</u>
<u>Employee</u>										
Smith	2,000	600	2,600	\$ 72,800	\$ 35	\$ 28	\$ 56,000	\$ 16,800	\$ 72,800	\$ 14,000
Ending Direct Labor:		\$ 70,000	(\$56,000 + \$14,000)							
Ending Indirect Labor:		\$ 2,800	(\$16,800 - \$14,000)			2,000 x [\$35 - \$28]		\$14,000		



# FAR COMPLIANT ICR

## *Frequent Issues with A&E ICRs*

- No/Inadequate documented Executive Compensation Analysis. Proper documentation should include a description of work performed for using either:
  - Salary Surveys with BenchmarksOr
  - National Compensation Matrix
- Allowability of compensation must be performed for all employees
- FAR 31.205-6(a) is the criteria for allowability
- FAR also identifies unallowable compensation and activities



# FAR COMPLIANT ICR

## *Frequent Issues with A&E ICRs*

- **Allowable Compensation** – generally, compensation for work performed in the current year that's reasonable in amount for the work performed, and is paid under an established compensation plan or policy.
- **Unallowable Compensation** – personal use of company vehicles or an auto allowance not supported by mileage logs; profit distribution that's not performance based; compensation that's deferred but not awarded before the end of the fiscal year, **Bonuses not performance based**, etc.
- **Unallowable Activities** – Advertising, Charitable activities, Entertainment, Lobbying, etc.



# FAR COMPLIANT ICR

## *Frequent Issues with A&E ICRs*

- Inadequate superior performance evaluation/documentation
  - Three or more financial performance measures representative of the executive's performance should be used
  - Not comparing themselves to firms in the same business, same size, and same revenue range
  - Extra compensation is not allowed simply because of high performance measured by a standard which is not affected by the executive's performance
  - Financial performance measures used should be applied consistently over a period of years, with both increases and decreases in the performance measures



# FAR COMPLIANT ICR

## *Frequent Issues with A&E ICRs*

- Using estimated in-house unit rates instead of creating cost centers and using actual costs

Example: Vehicles, Printing, Computers, CADD

- If used, these unit rates s/b offset to indirect expense pool as credits or cost recoveries for direct costs as they are used on projects
- Direct Cost unit rates must be supported by accounting records
- Burden of proof is A/E firm's responsibility

*Ch. 5.3, Cost Centers, p29, 2012 AASHTO Guide*





# FAR COMPLIANT ICR

## *Frequent Issues with A&E ICRs*

### *Example*

- Using estimated rates instead of actual costs
  - Mileage rates s/b supported by vehicle/mileage logs, supporting any Direct usage charges
  - Vehicle/mileage logs should track
    - Allowable Indirect usage
    - Unallowable Indirect usage - (i.e., Personal commute use)



# FAR COMPLIANT ICR

## *Frequent Issues with A&E ICRs*

- Insufficient documentation for ODCs.  
Documentation should include:
  - Identification and accumulation by cost objective
  - Support that rates are based on actual costs w/o mark-ups or profit
  - Support that ODCs are treated consistently
  - Support that ODCs were not included in indirect expense pool
  - “Like-cost” category are consistently allocated in accounting system
- Not all rates proposed in contract are audited.
  - Every rate proposed (e.g. Field Office, Home Office) needs to be audited for contracts \$3.5 M and above

*Tables 5-5 and 5-6, Sample ICR Schedules*



# FAR COMPLIANT ICR

## *Frequent Issues with A&E ICRs*

Classifying “Employee Morale” when costs are actually “Entertainment” in nature

- Examples of Employee Morale

- Painting, new carpet to improve workplace
- In-house health and wellness publications
- Employee counseling services

- Examples of Entertainment

- Gifts or prizes –not tied to performance based on formal policies
- Food, Drinks, Snacks, etc.
- Parties/Social Events, Shows/Sports Events, etc.

***Example:** Costs associated with mandatory Off-Site Staff Meetings requiring travel & lodging, food, prizes and entertainment will likely not be fully allowable. State Per Diem and Travel requirements and rates must be considered to determine allowability.*



# FAR COMPLIANT ICR

## *Frequent Issues with A&E ICRs*

### Documentation Requirements

- Adequate documentation must support FAR allowability
- Support for business purpose
- Who, what, when, where, why
- Receipts that are detailed/itemized
- Expense reports, company credit cards, and vendor invoices



# FAR COMPLIANT ICR

## *What to Look for When Selecting a CPA Firm to Perform an ICR Audit*

- CPA should meet all GAGAS Requirements (including CPE requirements)
- CPA should be well versed in:
  - GAGAS
  - FAR Part 31
  - Cost Accounting Standards
  - 23 U.S.C. 112



# FAR COMPLIANT ICR

## *What to Look for When Selecting a CPA Firm to Perform an ICR Audit*

- CPA should have working knowledge of the A&E industry.
- CPA should be well versed in job-cost accounting practices & systems used by A&E Firms

Prior experience conducting ICR  
(e.g. not Construction, F/S, etc. audits)  
Audits for A&E firms is important



# FAR COMPLIANT ICR

## *Resources*

- 2012 American Association of State Highway and Transportation Officials (AASHTO) Uniform Audit and Accounting Guide.
  - For Audits of A&E Consulting Firms
  - Appendix A – Review Program for CPA Audits of Consulting Engineers' ICR
  - Appendix B – Internal Control Questionnaire

<http://audit.transportation.org/Documents/UAAG-3%20FINAL.pdf>



## Resources

### ○ FHWA's National Highway Institute (NHI) Training

- FHWA-NHI-231028: *Using the AASHTO Audit Guide for the Procurement and Administration of A/E Contracts*
- FHWA-NHI-231029: *Using the AASHTO Audit Guide for the Development of A/E Consultant Indirect Cost Rates*
- FHWA-NHI-231030: *Using the AASHTO Audit Guide for the Auditing and Oversight of A/E Consultant Indirect Cost Rates*

<http://www.nhi.fhwa.dot.gov/default.aspx>





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# CPA Indirect Cost Rate Audits



# CPA INDIRECT COST RATE AUDITS

## *What A&I is Looking for in a CPA Workpaper Review*

Is the independent CPA's work sufficient to support their conclusions.

*Key.* Can a cold reader follow the independent CPA's work and come to the same conclusion.



# CPA INDIRECT COST RATE AUDITS

## *Purpose and Objective*

Purpose: To highlight frequently identified issues discovered during A&I's reviews of CPA's audits of Indirect Cost Rates (ICRs)

Objective: To help CPA firms be successful in auditing A&E firms' ICR



# CPA INDIRECT COST RATE AUDITS

## *Cognizant Audit*

An audit to obtain reasonable assurance that claimed costs are accordance with the FAR Subpart 31.2 cost principles

Such audit work may be performed by:

- Home-state auditors
- Federal audit agency
- CPA firm
- Non-home state auditor designated by the home-state auditor



# CPA INDIRECT COST RATE AUDITS

## *Cognizance*

- Determines who conducts the Review to issue a cognizant approval
  - The cognizant state is determined by where financial records are maintained
- Review may involve transfer of Cognizance if Home State is not conducting a review

CFR, Ch. 1, Part 172 – Administration of Engineering & Design Related Service Contracts



# CPA INDIRECT COST RATE AUDITS

## *CPA Workpaper (WP) Review*

- Performed by Caltrans Audits & Investigation (A&I)
- Full access to CPA's WP is required by contract provisions
- Review Independent CPA's WPs of ICR Audits
  - To ensure CPA's work performed in accordance with all applicable federal and state standards as well as, to verify the accuracy of the audited ICR

*Goal of a CPA WP Review is to issue a Cognizant Letter of Approval*



# CPA INDIRECT COST RATE AUDITS

## *Cognizant Letter of Approval*

- The “Cognizant Agency” issues a Cognizant Letter of Approval so that the ICR can be relied upon on future contracts with the consultant for a given year and for reliance by other state agencies using the same consultant
- If there are significant issues with the CPA’s audit of a consultant’s ICR, A&I will not be able to issue a Cognizant Letter of Approval

*Ch. 10.7, Failure To Meet Minimum Audit Procedures, p104,  
2012 AASHTO Guide*





# CPA INDIRECT COST RATE AUDITS

## *Differences in ICR and F/S Audits*

- ICR Audits Cover
  - Statement of Direct Labor, Fringe Benefits, and General Overhead
  - Report on Internal Control
- ICR Audits require 3 additional audit assertions
  - Allowability (FAR 31.201-2)
  - Reasonableness (FAR 31.201-3)
  - Allocability (FAR 31.201.4)



# CPA INDIRECT COST RATE AUDITS

## *Definitions*

- Allowability (FAR 31.201-2)
  - A cost is allowable only when the cost complies with all of the following requirements:
    - *Reasonableness.*
    - Allocability.
    - Cost Accounting Standards, GAAP, or other acceptable accounting methods.
    - Terms of the contract.
    - Other limitations of FAR subpart 31.2.
- Reasonableness (FAR 31.201-3)
  - “A cost is reasonable if, in its nature and amounts, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business.”



# CPA INDIRECT COST RATE AUDITS

## *Definitions*

- Allocability (FAR 31.201.4)
  - A cost is allocable if it is assignable/chargeable to one or more cost objectives or cost centers on the basis of either the relative benefits received or some other equitable relationship.
- Directly Associated Costs
  - A cost incurred as a result of incurring another related cost and typically associated with unallowable costs.
    - Example: Unallowable advertising/entertainment costs and associated direct labor



# CPA INDIRECT COST RATE AUDITS

## *Important to Note:*

When Federal and/or State Funds are Involved:

- There is more scrutiny
- Materiality levels should be lower
- More testing is required
- Should not be approached like a Financial Statement Audit



# CPA INDIRECT COST RATE AUDITS

## *Frequent Issues with CPA ICR Audits*

- Difficulty getting full access to CPA and/or their WPs
- Overall lack of documentation
  - Why steps were excluded
  - Clear and complete description of analysis
  - How conclusions were reached
- No Audit Program or Audit Program is not designed for an ICR Audit

*Ch. 10 , 2012 AASHTO Guide - guidance for developing audit procedures*



# CPA INDIRECT COST RATE AUDITS

## *Frequent Issues with CPA ICR Audits*

### Internal Control Testing

- Labor Charging Controls – most critical area
  - Examine P&Ps
  - Timesheet testing
  - Reconciliation between payroll system, job cost system, and general ledger
- Cash Disbursement Controls – key internal control area
  - Examine P&Ps
  - Test controls over purchasing and vendor payment



# CPA INDIRECT COST RATE AUDITS

## *Frequent Issues with CPA ICR Audits*

### Internal Control Testing

#### ○ Accounting System

- Proper segregation of Direct & Indirect costs
- Accumulation of Direct costs by cost objective
- Interface with timekeeping system?
- Periodic determination of costs charged to contracts through routine posting of costs?
- Are there controls to identify and exclude from costs charged to Government contracts unallowable amounts?



# CPA INDIRECT COST RATE AUDITS

## *Frequent Issues with CPA ICR Audits*

- Insufficient timesheet testing
- Insufficient support consultants performed Executive Compensation analysis
- Insufficient indirect expense testing
  - No support for compliance with allowability, reasonableness, allocability
  - No assurance on general F/S assertions
  - No support for large dollar or sensitive (LDS) transactions testing
  - Non-high risk accounts not tested

*Ch. 9.9 & 10.4, 2012 AASHTO Guide - information on LDS testing  
& materiality levels*





# CPA INDIRECT COST RATE AUDITS

## *Frequent Issues with CPA ICR Audits*

- Lack of documentation/explanation:
  - Consultant's accounting treatment of Uncompensated & Premium Overtime
  - Consultant's system accounts for all direct costs
  - If direct costs were audited for consistency
  - If “directly associated costs” were considered
- Insufficient disclosure or a complete review of Minimum Audit Report disclosure notes

*Ch. 5.3, Cost Centers, p29, 2012 AASHTO Guide*



# CPA INDIRECT COST RATE AUDITS

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# Safe Harbor Indirect Cost Rate



## *Purpose and Objective*

Purpose: To describe the utilization and requirements for using the safe harbor indirect cost rate (SHR)

Objective: To help eligible A&E firms understand the requirements for utilizing the SHR



# SAFE HARBOR ICR

## *SHR Background*

The Federal Highway Administration (FHWA) developed a national SHR of **110%** for eligible consulting firms to use on a test-evaluation basis. The testing period is from July 1, 2013 to June 30, 2016

### *Purpose*

- To remove financial management barriers that may prevent or inhibit new, small, disadvantaged or otherwise eligible A&E firms from entering into federal or state contracts
- To provide a framework for A&E firms to establish an adequate cost history to eventually develop a FAR compliant ICR



# SAFE HARBOR ICR

## *SHR Implementation*

- Caltrans DPAC instructions for state A&E contracts:
  - DPAC Website <http://caltrans-opac.ca.gov/aeinfo.htm>
- Caltrans DLA instructions for LGA A&E contracts via bulletin:
  - DLA Website [http://www.dot.ca.gov/hq/LocalPrograms/DLA\\_OB/DLA\\_OB.htm](http://www.dot.ca.gov/hq/LocalPrograms/DLA_OB/DLA_OB.htm)
- Caltrans A&I certification and questionnaire:
  - A&I Website <http://www.dot.ca.gov/hq/audits/>



# SAFE HARBOR ICR

## *SHR Eligibility Requirements*

- Firms that do not have a previously accepted ICR by a cognizant agency, or with an audited/accepted actual ICR within the established test period
- Firms that do not have relevant contract cost history to use as a base for developing its own indirect cost rate (consistent contract workload over consecutive years)



# SAFE HARBOR ICR

## *Additional SHR Requirements*

- All firms must have a project/cost accounting system capable of accumulating and tracking direct labor and other direct costs by contract, segregating indirect costs, and removing unallowable costs
- Fixed hourly labor rates need to be established for calculation of the direct labor portion of contracts
- Direct labor must be recorded
- SHR is not adjustable for the term of the contract
- No retroactive adjustment to indirect costs will be allowed for contracts utilizing the SHR





# SAFE HARBOR ICR

## *Additional SHR Requirements*

The SHR impacts the  
Indirect Cost Rate Only!

All other FAR Cost Principles  
must still be followed



# SAFE HARBOR ICR

## *What Eligible Firms Need to Do*

Eligible firms must complete and submit the following with their cost proposals:

- Consultant Certification of Eligibility; and Contract Costs and Financial Management System
- Questionnaire for Evaluating Consultant's Financial Management System

Upon satisfactory review, Caltrans A&I will issue an acceptance/approval

A rejection letter will be issued by A&I if the consultant cannot use the SHR



# SAFE HARBOR ICR

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# LAPM Chapter 10.3

## A&E Consultant Audit and Review Process



## LAPM CHAPTER 10.3 ~ A&E CONSULTANT AUDIT AND REVIEW PROCESS

### *Purpose and Objective*

Purpose: To highlight the changes in LAPM Chapter 10.3, “A&E Consultant Audit and Review Process”

Objective: To help Local Government Agencies (LGA). the consultant community, and independent CPAs be successful in submitting and auditing federal and state compliant A&E contracts



## LAPM CHAPTER 10.3 ~ A&E CONSULTANT AUDIT AND REVIEW PROCESS

### *Contracts/Consultants Selected for Audit or Review*

Risk based approach dictated by dollar amount and other risk factors such as:

- History of satisfactory performance
- Prior FAR compliant history and audit frequency
- Financial stability
- Conformance to terms and conditions of previous contracts
- General responsiveness and responsibility
- The approximate dollar amount of all A&E contracts awarded to the consultant by Caltrans or a local agency in California within the last three calendar years.
- The number of states in which the consultant does business
- The type and complexity of the consultant's accounting system
- The relevant professional experience of any certified public accountant (CPA) performing audits of the consultant's ICR(s)
- Responses to internal control questionnaire (ICQ), see AASHTO Audit Guide, Appendix B
- Changes in the organizational structure



## LAPM CHAPTER 10.3 ~ A&E CONSULTANT AUDIT AND REVIEW PROCESS

### *Contracts/Consultants Selected for Audit or Review*

- If audited or reviewed, contracts, cost proposals, and ICRs are required to be modified to conform to the audit or review recommendations
- LGAs are responsible for ensuring recommendations are implemented
- LGAs are subject to sanctions outlined in LAPM, Ch 10, <http://www.dot.ca.gov/hq/LocalPrograms/lam/lapm.htm>
- If provisions, unallowable charges, unsupported activities, or reimbursement is a result of a lack of proper contract an inadequate financial management system



## LAPM CHAPTER 10.3 ~ A&E CONSULTANT AUDIT AND REVIEW PROCESS

### *Why are Subconsultants Included?*

- 23 U.S.C. (b) (2) (B) – Letting of Contracts states:  
*Any contract or subcontract awarded in accordance with subparagraph (A), whether funded in whole or in part with Federal-aid highway funds, shall be performed and audited in compliance with cost principles contained in the Federal Acquisitions Regulations of part 31 of title 48, Code of Federal Regulations.*
- Proposed federal requirements to review subconsultants (23 CFR, Part 172)





## LAPM CHAPTER 10.3 ~ A&E CONSULTANT AUDIT AND REVIEW PROCESS

### *How are Subconsultants Impacted?*

Subconsultants are required to:

- Certify their contract costs and financial management system when *total* contract is \$150,000 or greater – not just their portion. (LAPM Exhibit 10-K)
- Use the accrual basis of accounting when developing their ICR
- Have an adequate job cost system to identify and segregate project costs
- Submit their cost proposals with the Prime's request for audit process (LAPM Exhibit 10-A) when the *total* contract is \$1 million or greater



## LAPM CHAPTER 10.3 ~ A&E CONSULTANT AUDIT AND REVIEW PROCESS

### *Types of Audits and Reviews Performed*

While Caltrans reserves the right to audit or review any contract described in this chapter typical audits and reviews are as follows:

#### *For Contracts less than \$1 Million (Case 1)*

- Contract Audits
- Risk Assessments
- Incurred Cost Audits
- Financial Management System Reviews

Case 1 contracts require a certification of contract and financial management systems cost,  
(LAPM Exhibit 10-K)



## LAPM CHAPTER 10.3 ~ A&E CONSULTANT AUDIT AND REVIEW PROCESS

### *Types of Audits and Reviews Performed*

#### *For Contracts great than or equal to \$1 Million (Case 2)*

- Indirect Cost Rate (ICR) Audits.

Includes examination of the consultant's proposed ICR for the applicable one-year accounting period to ensure it is in compliance with FAR cost principles

If in compliance with FAR cost principles, a Cognizant Letter of Approval will be issued



## LAPM CHAPTER 10.3 ~ A&E CONSULTANT AUDIT AND REVIEW PROCESS

### *Case 2 Contracts Require:*

- All requirements in Case 1 above – certification of contract costs and financial management system (LAPM Exhibit 10-K)

AND

- A&E consultant audit request letter and checklist, (LAPM Exhibit 10-A):
  - Proposed contract
  - Cost proposals – Prime and Subs
  - Contacts
  - ICR Schedule
  - Internal Control Questionnaire (AASHTO Audit Guide, Appendix B)
  - Prior year cognizant approved or audited ICR if available



## LAPM CHAPTER 10.3 ~ A&E CONSULTANT AUDIT AND REVIEW PROCESS

### *Types of Audits and Reviews Performed*

For Contracts equal to/greater than \$3.5 Million (Case 3)

- CPA Audited ICR Workpaper Review

Includes a review of the CPA's workpapers to determine whether:

- The audit was conducted in accordance with GAGAS
- The CPA adequately considered the consultant's compliance with FAR
- The audit report format, notes, and disclosures are acceptable

If in compliance with FAR cost principles, a Cognizant Letter of Approval will be issued.



## LAPM CHAPTER 10.3 ~ A&E CONSULTANT AUDIT AND REVIEW PROCESS

### *Case 3 Contracts Require:*

- All requirements in Case 2 above

AND

- One of the following:
  - Another state DOT's approved ICR schedule AND Cognizant Letter of Approval
- OR
- CPA Audited ICR (Required) AND Audited F/S (if any)



## LAPM CHAPTER 10.3 ~ A&E CONSULTANT AUDIT AND REVIEW PROCESS

### *Conformance Letter*

A&I will review all Case 2 and 3 audit requests for the following in order to issue a Conformance Letter:

- If all elements are included with LAPM Exhibit 10-A (i.e. Complete Packet)
- If cost proposal(s) are in the correct format (see LAPM 10.2 *Determine Method of Payment* and Exhibit 10-H)
- Internal Control Questionnaire (AASHTO Audit Guide, Appendix B) – and all required attachments
  - Must have a job-cost accounting system
  - Must have prepared the overhead schedule on accrual basis



## LAPM CHAPTER 10.3 ~ A&E CONSULTANT AUDIT AND REVIEW PROCESS

### *Conformance Letter*

A&I will review all Case 2 and 3 requests for the following (cont.):

- If all required fiscal provisions are included in the proposed contract (LAPM Exhibit 10-R):
  - Performance Period, begin and end date (Article IV);
  - Allowable Costs and Payments (Article V);
  - Termination (Article VI);
  - **Cost Principles and Administrative Requirements (Article X);**
  - **Retention of Records/Audit (Article XII);**
  - Audit Review Procedures, AUDIT CLAUSE (Article XIV. D.) **must be verbatim;**
  - Subcontracting (Article XV);
  - Equipment Purchase (Article XVI);
  - State Prevailing Wage Rates (Article XXVII);
  - Conflict of Interest (Article XXVIII);
  - Rebates, Kickbacks or other Unlawful Consideration (Article XXIX);
  - Prohibition of Expending State or Federal Funds for Lobbying (Article XXX).





## LAPM CHAPTER 10.3 ~ A&E CONSULTANT AUDIT AND REVIEW PROCESS

### *Conformance Letter*

- Conformance Letter will identify any deficiencies
- Deficiencies addressing *requirements* must be corrected before contract can be executed but do not need to be cleared through A&I before doing so
- Deficiencies addressing *suggestions* are to be corrected as necessary before contract can be executed but do not need to be cleared through A&I before doing so
- Executed contract must be submitted to A&I
- Contracts cannot be executed until A&I issues a Conformance Letter
- Conformance Letters will be issued within 30 business days of receipt of a complete request packet



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### *Frequent Issues with Conformance Letter*

- Contract payment method is not clear
- Cost proposals are not in the correct format

### LAPM, Chapter 10.2

#### *“DETERMINE METHOD OF PAYMENT*

The method of payment of contract must be specified. Four methods are permitted depending on the scope of services to be performed:

- Actual Cost-Plus-Fixed Fee (see LAPM Exhibit 10-H, Example #1);
  - Cost Per Unit of Work (see LAPM Exhibit 10-H, Example #3);
  - Specific Rates of Compensation (see LAPM Exhibit 10-H, Example #2);
  - Lump Sum (see LAPM Exhibit 10-H, Example #1).”
- 

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### *Frequent Issues with Conformance Letter cont.*

- Cost proposals for all subconsultants are missing
- Certifications (Exhibit 10-K) are not submitted for subconsultants
- ODCs are not itemized on cost proposals
- Key personnel are not named on cost proposals
- Not all required fiscal provisions are included



## LAPM CHAPTER 10.3 ~ A&E CONSULTANT AUDIT AND REVIEW PROCESS

### *Frequent Issues with Conformance Letter cont.*

- Beginning and end dates of Agreement are missing
- AUDIT CLAUSE is not included – **must be verbatim** (LAPM Audit Review Procedures Article XIV. D)
- Outdated versions are used (e.g. LAPM Exhibits 10-A, 10-K)
- “Fiscal Period Covered” on Certification (LAPM Exhibit 10-K) should be the fiscal period the Indirect Cost Rate was developed



# LAPM CHAPTER 10.3 ~ A&E CONSULTANT AUDIT AND REVIEW PROCESS

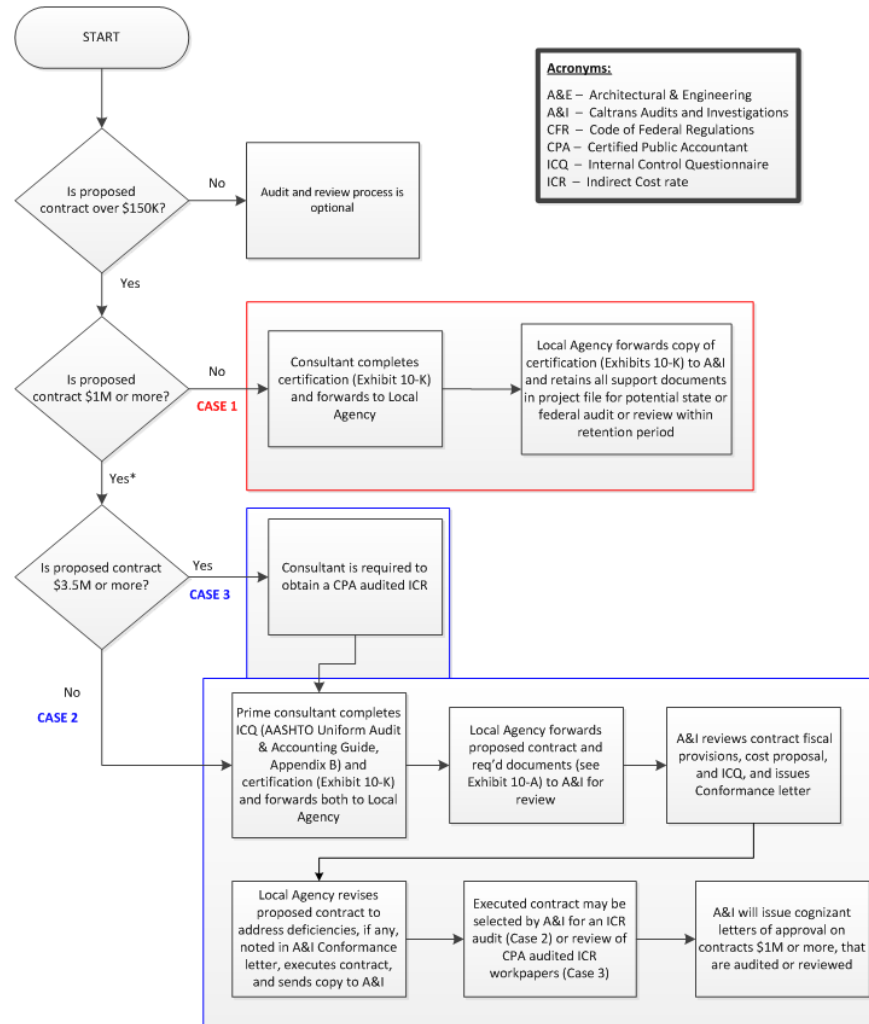
## Summary of Contracts to be Audited or Reviewed

<i><b>Proposed Contract Amount</b></i>	<i><b>Documents Required</b></i>	<i><b>Conformance Letter Issued?</b></i>	<i><b>Audit/Review</b></i>	<i><b>If Audited or Reviewed will Cognizant Letter of Approval be Issued?</b></i>
Less than \$150K	None	No	Audit/review optional	N/A
Between \$150K and \$1M <b>Case 1.</b>	Certifications by Consultants, including subs (Exhibit 10-K)	No	May be selected for Audit or Review.	<i><b>If</b></i> Indirect Cost Rate (ICR) Audit is performed.
Between \$1M and \$3.5M <b>Case 2.</b>	Proposed contract, certifications, Internal Control Questionnaire, etc. (Exhibit 10-A.)	Yes	May be selected for ICR Audit.	Yes
\$3.5M or greater <b>Case 3.</b>	Proposed contract, certifications, Internal Control Questionnaire, etc. <b>AND</b> CPA Audited ICR. (Exhibit 10-A)	Yes	May be selected for Review of CPA's workpapers of audited ICR	Yes



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## Audit Process Flowchart



\* Note: For A&E consultant contracts of \$1M or more, local agency may begin, but not conclude cost negotiations with the best qualified firm until a Conformance Letter is received from A&I.

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